

Inspector General

United States

Department *of* Defense



Oversight Review

June 29, 2009

Report on Quality Control Review
of Deloitte & Touche, LLP FY 2007 Single Audit of
Battelle Memorial Institute and Subsidiaries

Report No. D-2009-6-007

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400 Army Navy Drive (Room 833)
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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

JUN 29 2009

Board of Directors
Battelle Memorial Institute

Vice President-Corporate Controller
Battelle Memorial Institute

Partner
Deloitte & Touche, LLP

SUBJECT: Report on Quality Control Review of Deloitte & Touche, LLP FY 2007 Single Audit of Battelle Memorial Institute and Subsidiaries (Report No. D-2009-6-007)

We are providing this report for your information and use. We considered management comments on a draft of this report when preparing the final report. As the cognizant Federal agency for Battelle Memorial Institute and Subsidiaries (Battelle), we performed a review of the Deloitte & Touche, LLP single audit and supporting workpapers for the fiscal year ended September 30, 2007. The purpose of our review was to determine whether the audit was conducted in accordance with auditing standards¹ and the auditing and reporting requirements of Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," (Circular A-133). Appendix A contains additional background, scope and methodology for the review and Appendix B lists the applicable compliance requirements.

Background. Battelle is a nonprofit organization formed in 1925 and headquartered in Columbus, Ohio. Battelle's major source of revenue is from technology-based research, management, commercialization, and education services to government and industrial clients. Battelle expended \$742.2 million in Federal awards for the fiscal year ended September 30, 2007 under one Federal program, the Research and Development Cluster. Of the \$742.2 million, \$474.0 million was expended for Department of Defense programs.

Review Results. Deloitte & Touche did not fully comply with auditing standards and Circular A-133 requirements for the Battelle FY 2007 single audit. Specifically, the auditors did not adequately plan the audit or adequately perform and document audit procedures for eight of ten applicable compliance requirements (Findings A & B). Because of the deficiencies identified in our review, additional audit work is needed before Federal agencies can rely on the audit to monitor and manage Federal award programs.

¹ Auditing standards include both Government Auditing Standards and the American Institute of Certified Public Accountants audit standards.

As a result of our discussions with Deloitte & Touche, the auditors took immediate corrective actions on the deficiencies cited in this report. During the period September 2008 through December 2008, Deloitte & Touche provided our office with documentation and further explanation of audit work and additional audit procedures performed. The supplemental audit work partially corrected the deficiencies identified; however, further audit procedures are needed to support audit conclusions and the overall opinion on compliance for the research and development cluster. Specifically, additional risk assessment procedures are needed to determine the design and extent of further audit procedures necessary to support the conclusions for the equipment; procurement, suspension and debarment; and subrecipient monitoring requirements. Additional procedures are also necessary to support the conclusions on Battelle's responsibility to perform specific monitoring procedures of subrecipients during award performance. During our exit conference with Deloitte & Touche, we also discussed opportunities for future enhancements to the single audit. These enhancements are discussed in the "Other Matters" section of this report.

Battelle generally met Circular A-133 reporting requirements except that the Schedule of Expenditures of Federal Awards did not fully identify Federal awards received as a subrecipient or awards by major subdivision (Finding C).

Management Comments and DoD IG Response. The Audit Partner, Deloitte & Touche, and the Vice-President-Corporate Controller, Battelle Memorial Institute, agreed to take the recommended actions. Management comments were responsive and conform to requirements; no additional comments are needed. The Deloitte & Touche comments state that a risk assessment and further audit procedures were performed on the equipment; procurement, suspension and debarment; and subrecipient monitoring requirements. Once provided, the DoD IG will review working paper documentation on the additional audit procedures performed to determine whether Federal agencies can rely on the FY 2007 single audit to monitor and manage Federal award programs.

Findings

Finding A. Audit Planning and Performance. Deloitte & Touche did not adequately plan the audit because the sampling methodology did not comply with auditing standards and Circular A-133 requirements for testing internal control over compliance and compliance with each applicable compliance requirement in the research and development cluster. In addition, the auditors did not perform adequate procedures for the items tested for the cash management and subrecipient monitoring requirements because the procedures did not address the objectives as defined in the Circular A-133 Compliance Supplement. As a result, we were unable to determine if there was sufficient competent evidence to support the auditor's conclusions that Battelle complied with the Federal requirements for cash management; equipment; procurement, suspension and debarment; and the monitoring of subrecipient awards.

Circular A-133 requires the auditor to perform procedures to obtain an understanding of internal control over compliance for Federal programs sufficient to plan the audit to support a low assessed level of control risk and perform the test of controls as planned. Based on the test of controls, the auditor should determine the amount of substantive testing needed to provide sufficient evidence to determine compliance with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on its major programs.

The American Institute of Certified Public Accountants audit standards on sampling, AU §350.17 states that "when planning a particular sample, the auditor should consider the specific audit objective to be achieved and determine the audit procedures, or combination of procedures, to be applied to achieve that objective. The auditor should determine that the population from which the sample is drawn is appropriate for the specific audit objective."

Audit Planning. The Deloitte & Touche auditors did not plan the testing of internal control to support a low assessed level of control risk for the objectives relevant to each compliance requirement as required by Circular A-133. Rather, the auditors assessed the risk for allowable activities and allowable costs and determined that a sample size of 50 would provide sufficient evidence to support the conclusions on internal control and compliance. They then planned to use the same sample to test the internal control and compliance objectives for the following additional five requirements: cash management; equipment; period of availability; procurement, suspension and debarment; and subrecipient monitoring. However, the auditors were unable to test all items in the sample to the objectives for three of the additional five compliance requirements. As a result auditors only tested 7 items for equipment, 13 items for procurement, 17 items for suspension and debarment, and 9 items for subrecipient monitoring. Because the auditors did not perform the required risk assessment procedures on each compliance requirement, there was no documented basis to suggest that these sample sizes provided sufficient evidence to support the conclusions for these three requirements.

After the site visit, Deloitte & Touche explained they never planned to test 50 selections for each compliance requirement. Rather, their audit plan was to select 50 items that represented characteristics of the entire population and test only those selections relevant to the individual compliance requirements. Since this approach is not consistent with auditing standards and Circular A-133 requirements we advised Deloitte & Touche that additional internal control and compliance procedures are needed to support the specific audit conclusions for the equipment; procurement, suspension and debarment; and subrecipient monitoring requirements and the overall opinion on compliance for the research and development cluster. These procedures should include an assessment of the risks of noncompliance for internal controls relevant to the objectives of the compliance requirement and be used as a basis for determining the design and extent of further audit procedures needed to support the conclusions for each of the three compliance requirements.

Performance of Internal Control and Compliance Testing. In addition to the overall deficiency in the sampling approach used, for the items tested, Deloitte & Touche did not perform adequate procedures on internal control over and compliance with subrecipient monitoring requirements or perform adequate procedures for the cash management requirement.

During our site visit, we requested the auditor to provide additional explanation and support for the audit procedures performed; however, the auditor was unable to provide additional information to mitigate the deficiencies identified.

Cash Management Compliance Requirements. The Deloitte & Touche auditors did not perform adequate audit procedures to determine Battelle's internal control over and compliance with the cash management requirements as they relate to cost reimbursement contracts. Cost reimbursement contracts represent approximately 76% of all Battelle contracts. The objective of this requirement for organizations funded on a reimbursement basis is to verify that program costs are paid for by the organization before reimbursement is requested from the Federal government.

The auditors documented understanding of Battelle's control processes did not focus on the cost reimbursement objectives. As a result the auditors did not identify or test controls in place to ensure costs are paid by Battelle before requesting government reimbursement. During our site visit, the auditors provided an explanation on procedures performed in the financial statement audit as support for internal control testing for this requirement. However, the explanation was either not relevant or failed to show a relationship between the controls tested and the cost reimbursement requirement. For example, the auditors directed us to a review of the aging of accounts payable, but this workpaper did not identify any internal controls tested. The auditors also identified the internal control testing of automated match controls and match exception reports but could not explain how the matching controls ensure that costs are paid by Battelle before requesting government reimbursement. For compliance testing, the auditors compared the date government reimbursement was requested to the date that the government reimbursement was received. This testing does not meet the objectives for this requirement because it does not provide any evidence that Battelle paid the costs before requesting reimbursement from the government.

Deloitte & Touche Corrective Actions. In November 2008, Deloitte & Touche provided our office with documentation on additional audit procedures performed to correct the deficiencies we identified in the audit of the Cash Management compliance requirement. Based on our review of the supporting documentation provided and additional verbal explanations provided by Deloitte & Touche, we consider the Deloitte & Touche corrective actions sufficient for the FY 2007 audit.

Subrecipient Monitoring Compliance Requirements. The workpapers demonstrated that the auditor obtained an understanding of internal control over subrecipient monitoring requirements. However, for the nine items tested, the auditors did not perform adequate audit procedures to test the internal control and compliance objectives of this requirement. The objectives of this compliance requirement include determining whether Battelle properly identified Federal award information and compliance requirements in subrecipient award documents, monitored subrecipient activities during the award period to provide reasonable assurance that subrecipients administered pass-through awards in compliance

with award requirements, ensured that subrecipients met Circular A-133 audit requirements, and took the required actions on audit findings, including evaluating the effect of any findings on Battelle awards.

For the transactions tested, the workpaper documentation supporting the review of Battelle's actions to monitor subrecipient awards during the award period was limited to a statement that the type of monitoring performed by Battelle is dependent upon the subrecipient. No additional information was provided to substantiate specific testing on Battelle's monitoring activity. In addition, we were unable to ascertain from the workpapers how the auditors tested the other objectives of the requirement such as whether award information was properly identified in subrecipient award documents and whether Battelle ensured that subrecipients met Circular A-133 audit requirements or took actions to evaluate the effect of subrecipient findings on its Federal awards.

Deloitte & Touche Corrective Actions. Between September and November 2008, the auditors provided additional explanations on the internal control and compliance testing performed on the identification of award information and subrecipient audit requirements and findings. Because we could tie the auditor's explanations to the controls identified in the written understanding and the audit plan, we determined that the procedures performed on the selections tested, although not adequately documented, met objectives. However, the auditors did not provide any additional information or perform additional procedures to support the conclusions on Battelle's responsibility to perform specific monitoring procedures during award performance.

Finding B. Documentation of the Federal Program Audit. The Deloitte & Touche auditors did not adequately document the internal control and compliance testing for the activities allowed/unallowed, allowable costs/cost principles, reporting, and special tests and provisions requirements. In addition, for the allowability of costs the auditors did not identify the specific cost principle criteria under which the costs were reviewed for allowability. The auditors also did not include adequate documentation to support the conclusions on the accuracy and completeness of the Schedules of Expenditures of Federal Awards. As a result, we spent significant time obtaining verbal explanations and reviewing additional information provided by the auditors that was not included in the Federal program audit workpapers to enable us to determine that there was sufficient evidence to support Deloitte & Touche audit conclusions on these requirements.

Government Auditing Standards require that sufficient detail be included in the audit documentation to provide an experienced auditor who has had no previous connection with the audit to ascertain from the documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should be appropriately detailed to provide a clear understanding of its purpose and source and should be appropriately organized to provide a clear link to the findings, conclusions, and recommendations.

Conclusion. The Deloitte & Touche audit work did not meet the requirements of Circular A-133, the related Compliance Supplement, and auditing standards. As a result, Federal agencies

and pass-through entities cannot rely on the audit report for assurance that Battelle is managing Federal awards in compliance with laws, regulations, and award provisions. We spent considerable time reviewing additional documentation and discussing work paper content with the auditors to make our determinations on the adequacy of the audit work. Deloitte & Touche also spent additional time supporting and re-performing the audit work. Because of the deficiencies discussed in this report, we conclude that the FY 2007 audit was not adequately supervised and that additional supervision is needed in future single audits to ensure that audit staff work complies with auditing standards and Circular A-133 requirements.

Recommendations and Management Comments

1. We recommend that the Audit Partner, Deloitte & Touche, LLP:

- a. Perform a risk assessment and further audit procedures, at no additional cost to the government, to determine the adequacy of Battelle Memorial Institute's internal control over and compliance with the equipment; procurement, suspension, and debarment; and subrecipient monitoring compliance requirements for the FY 2007 audit.**
- b. Provide the Department of Defense Office of Inspector General with the working paper documentation that demonstrates corrective actions taken to address the reported deficiencies on the FY 2007 audit of the equipment; procurement, suspension, and debarment; and subrecipient monitoring compliance requirements.**
- c. Revise the single audit reporting package to reflect, at a minimum, the date additional audit work was completed and forward the revised reporting package and signed Data Collection Form to Battelle Memorial Institute to file with the Federal Audit Clearinghouse.**
- d. Provide the Department of Defense Office of Inspector General with the working paper documentation from the FY 2008 single audit that demonstrates corrective actions taken to address the planning, performance and documentation deficiencies identified in the review of internal control and compliance and the documentation of the review of the Schedule of Expenditures of Federal Awards.**
- e. Strengthen existing or implement additional Deloitte & Touche quality procedures that provide for the adequate supervision of audit staff performing future Office of Management and Budget Circular A-133 single audits so that future audits comply with auditing standards and the audit requirements of the Office of Management and Budget Circular A-133 for the planning, performance, and documentation of the audit.**

Deloitte & Touche Comments. Deloitte & Touche agreed to take the recommended actions.

Finding C. Schedule of Expenditures of Federal Awards. Battelle did not correctly prepare the FY 2007 Schedule of Expenditures of Federal Awards because the schedule did not separately identify all pass-through awards received by Battelle and did not identify all Federal awards by major subdivision in accordance with Circular A-133 requirements. Circular A-133 section §.310(b) requires for awards received as a subrecipient, the identifying number assigned by the pass-through entity be included in the schedule. In addition, for research and development cluster, Federal awards must be shown either by individual award or by Federal agency and major subdivision within the Federal agency.

Battelle grouped multiple awards received from a pass-through entity rather than separately identifying the awards along with the specific identifying number the pass-through entity assigned to the award. Additionally, Battelle identified some expenditures by major subdivision for awards received directly from Federal agencies; however, multiple other direct awards and all awards received as a subrecipient were not identified by major subdivision. For example, Battelle identified all DoD direct awards received from the Army, Navy, and Air Force as separate line items in the Schedule of Expenditures of Federal Awards, but grouped DoD awards received from multiple DoD agencies into one line item identified as "DoD Other". Unless there is a reason to protect the identity of an awarding agency, awards in the research and development cluster should be shown either by individual award or by major subdivision within the Federal agency. This information is required so that Federal awarding agencies and pass-through entities can use the Schedule of Expenditures of Federal Awards to monitor awards.

Recommendations and Management Comments

- 2. We recommend that the Vice President, Corporate Controller, Battelle Memorial Institute:**
 - a. Prepare the Schedule of Expenditures of Federal Awards according to the Office of Management and Budget Circular A-133 requirements for future single audits. Specifically, the Schedule of Expenditures of Federal Awards must include the identifying number assigned by the pass-through entity and awards should be shown either by individual award or by Federal agency and major subdivision within the Federal agency.**
 - b. Direct Deloitte & Touche, LLP, to perform additional procedures to address deficiencies identified in the FY 2007 single audit of Battelle Memorial Institute at no additional cost to the Government.**
 - c. File the revised FY 2007 Reporting Package and signed Data Collection Form with the Federal Audit Clearinghouse and notify the DoD Office of the Inspector General upon completion.**

Battelle Memorial Institute Comments. The Vice-President-Corporate Controller, Battelle Memorial Institute, agreed to take the recommended actions.

Other Matters. To enhance future single audits, we suggest the Deloitte & Touche auditors coordinate directly with the Defense Contract Audit Agency when planning the audit. While the auditors reviewed Defense Contract Audit Agency audit reports obtained from Battelle, Deloitte & Touche should ensure that copies of all audit reports that could impact the audit period be reviewed to achieve a more efficient and effective audit.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Janet Stern at (703) 604-8750 (DSN 664-8750).



Carolyn R. Davis
Assistant Inspector General
for Audit Policy and Oversight

Appendix A. Quality Control Review Process

Background, Scope and Methodology

The Single Audit Act, Public Law 98-502, as amended, was enacted to improve the financial management of State and Local Governments and nonprofit organizations by establishing one uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. Circular A-133 establishes policies that guide implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. Entities that expend \$500,000 (for fiscal years ending after December 31, 2003) are subject to the Single Audit Act and the audit requirements in Circular A-133 and therefore must have an annual single or program-specific audit performed under Government Auditing Standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We reviewed the Deloitte & Touche, LLP FY 2007 single audit of Battelle Memorial Institute and Subsidiaries and the reporting package that was submitted to the Federal Audit Clearinghouse on July 2, 2008 using the 1999 edition of the “Uniform Quality Control Review Guide for the A-133 Audits” (the Guide). The Guide applies to any single audit that is subject to the requirements of Circular A-133 and is the approved President’s Council on Integrity and Efficiency² checklist used for performing the quality control reviews. We performed the review from August 2008 through May 2009. The review focused on the following qualitative aspects of the single audit:

- Qualification of Auditors,
- Independence,
- Due Professional Care,
- Planning and Supervision,
- Internal Control and Compliance testing,
- Schedule of Expenditures of Federal Awards, and
- Data Collection Form.

² The President’s Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency combined into the Council of the Inspectors General on Integrity and Efficiency in accordance with the Inspector General Reform Act of 2008.

Prior Quality Control Reviews

Since October 1, 2003, we have performed one quality control review of a Deloitte & Touche Circular A-133 audit. The quality control review identified deficiencies resulting in findings and recommendations on performance and documentation. Unrestricted IG DoD reports can be accessed at <http://www.dodig.osd.mil/audit/reports>.

Appendix B. Compliance Requirements

The Deloitte & Touche auditors determined that the following requirements are applicable to the single audit of the Battelle Memorial Institute and Subsidiaries for the fiscal year ended September 30, 2007.

Compliance Requirements	Applicable	Not Applicable/ Not Material
Activities Allowed/Unallowed	X	
Allowable Costs/Cost Principles	X	
Cash Management	X	
Davis-Bacon Act		X
Eligibility		X
Equipment and Real Property Management	X	
Matching, Level of Effort, Earmarking		X
Period of Availability of Federal Funds	X	
Procurement, Suspension, and Debarment	X	
Program Income	X	
Real Property Acquisition and Relocation Assistance		X
Reporting	X	
Subrecipient Monitoring	X	
Special Tests and Provisions	X	

Deloitte & Touche Management Comments

Deloitte.

June 12, 2009

Deloitte & Touche LLP
155 East Broad Street
Columbus, OH 43215-3611
USA
Tel: +1 614 221 1000
Fax: +1 614 229 4647
www.deloitte.com

Inspector General
Department of Defense
400 Army Navy Drive
Arlington, Virginia 22202-4704

SUBJECT: Responses to Your Report on Review of Deloitte & Touche, LLP FY 2007 Single Audit of Battelle Memorial Institute and Subsidiaries (Project No. D2008-DIP0AC-0239

This letter is in response to your recommendations as outlined in your letter.

1a. We have preformed a risk assessment and further audit procedures, at no additional cost to the government, to determine the adequacy of Battelle Memorial Institute's internal control over and compliance with the equipment; procurement, suspension, and debarment; and subrecipient monitoring compliance requirements.

1b. Upon issuance of the revised report we will provide the working paper documentation with the additions highlighted.

1c. Upon completion of additional audit procedures, *The Report on Federal Awards in Accordance with OMB Circular A-133 for the Year Ended September 30, 2007 and Independent Auditors' Reports* will be reissued and will include dual dated opinions and an additional note to the Schedule of Expenditures of Federal Awards will be added, to outline the reasons for the report reissuance. The revised reporting package and signed Data Collection Form will be sent to Battelle Memorial Institute to file with the Federal Audit Clearinghouse.

1d. Upon completion of the fiscal year 2008 single audit and the receipt of access letters signed by Battelle Memorial Institute and The Inspector General of the Department of Defense, we will provide the fiscal year 2008 working paper documentation.

1e. Based on the comments and discussions with your office we have revised our procedures surrounding Battelle's single audit. These revisions will be incorporated into future Office of Management and Budget Circular A-133 single audits and incorporated into future staff trainings.

Sincerely,



Kristine G. Devine

Member of
Deloitte Touche Tohmatsu

Battelle Memorial Institute Management Comments

Final Report
Reference



June 4, 2009

Ms. Carol Vogler
Single Audit Technical Specialist
Department of Defense
Office of the Inspector General
Audit Policy and Oversight
400 Army Navy Drive
Arlington, Virginia 22202-4704

SUBJECT: Draft Report on Quality Control Review of FY07 Battelle Single Audit

Battelle will implement Recommendations 1.a., b., and c. by preparing future Schedules of Expenditures of Federal Awards with the recommended additional detail, by directing Deloitte and Touche to perform the required additional procedures at no additional cost to the Government, and by filing a revised FY2007 Reporting Package and Data Collection Form and notifying the DoD IG upon completion of the filing. We expect to have the revised Reporting Package and Form filed by June 30, 2009.

Renumbered as
Recommendations 2.a.,
b., and c.

Sincerely,

A handwritten signature in black ink that reads "Stephen H. Valentine".

Stephen H. Valentine
Vice President – Corporate Controller

SHV/Isn

505 King Avenue Columbus, Ohio 43201-2693 800.201.2011 solutions@battelle.org www.battelle.org



Inspector General Department of Defense

